

**The City of San Jose Police and Fire Department
Medical and Dental Insurance Plan**

*Actuarial Valuation and Review of Other Postemployment
Benefits (OPEB) as of June 30, 2006
In accordance with GASB Statements No. 43 and No. 45*

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October 24, 2006

*Board of Retirement
City of San Jose
Police and Fire Department Retirement Plan
1737 N First Street, Suite 580
San Jose, CA 95112-4505*

Dear Members of the Board

We are pleased to submit this report on our actuarial valuation of postemployment welfare benefits as of June 30, 2006 under GASB. It establishes the liabilities of the Medical and Dental Benefits Plan in accordance with GASB for the current year. It also summarizes the actuarial data used in this valuation.

This report is based on information received from the Department of Retirement Services. The actuarial projections were based on the assumptions and methods described in Exhibit II and on the plan of benefits as summarized in Exhibit III.

We look forward to discussing this material with you at your convenience.

Sincerely,

THE SEGAL COMPANY

*By: _____
Paul Angelo, FSA, MAAA, FCA
Senior Vice President & Actuary*

*_____
Andy Yeung, ASA, EA, MAAA
Associate Actuary*

DTB/hy

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PURPOSE

This report presents the results of our actuarial valuation of the City of San Jose Police and Fire Department Retirement Plan (Police and Fire Department) post retirement medical and dental benefits as of June 30, 2006. The results are in accordance with the Governmental Accounting Standards, which prescribes an accrual methodology for accumulating the value of other postemployment benefits (OPEB) over participants' active working lifetimes. For most employers, the accounting standard supplements cash accounting, under which the expense for postemployment benefits is equal to benefit and administrative costs paid on behalf of retirees and their dependents (*i.e.*, a pay-as-you-go basis).

Actuarial computations under GASB are for purposes of fulfilling certain welfare fund accounting requirements. The calculations reported in this report have been made on a basis consistent with our understanding of GASB. Determinations for purposes other than meeting the financial accounting requirements of GASB may differ significantly from the results reported here.

Calculations are based on the benefits provided under the terms of the substantive plan in effect at the time of the valuation and on the pattern of sharing costs between the employer and plan members. The projection of benefits does not incorporate the potential effect of legal or contractual funding limitations on the pattern of cost sharing between the employer and plan members in the future.

Actuarial calculations reflect a long-term perspective, and the methods and assumptions use techniques designed to reduce short term volatility in accrued liabilities and the actuarial value of assets.

The calculation of an accounting obligation does not, in and of itself, imply that there is any legal liability to provide the benefits valued, nor is there any implication that Police and Fire Department is required to implement a funding policy to satisfy the projected expense.

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future, and the actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

ACCOUNTING REQUIREMENTS

The Governmental Accounting Standards Board (GASB) issued Statement Number 45 -- *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. Under this statement, all plans of state and local government entities that provide other post employment benefits (OPEB) are required to report the cost of these benefits on their financial statements.

The statement includes postemployment benefits of health, prescription drug, dental, vision and life insurance coverage for retirees; long-term care coverage, life insurance and death benefits that are *not* offered as part of a pension plan; and long-term disability insurance for employees. These benefits, referred to as OPEB, are typically financed on a pay-as-you-go basis. The new standard introduces an accrual-basis accounting requirement; thereby, recognizing the employer cost of postemployment benefits over an employee's career. The standards also introduce a consistent accounting requirement for both pension and non-pension benefits.

The total cost of providing postemployment benefits is projected, taking into account assumptions about demographics, turnovers, mortality, disability, retirement, health care trends, and other actuarial assumptions. This amount is then discounted to determine the actuarial present value of the projected cost of these benefits (APB). The actuarial accrued liability (AAL) is the portion of the present value of the total projected benefits allocated to years of employment prior to the measurement date. The unfunded actuarial accrued liability (UAAL) is the difference between the AAL and actuarial value of assets in the Plan.

Once the UAAL is determined, the Annual Required Contribution (ARC) is determined as the normal cost (the APB allocated to the current year of service) and the amortization of the UAAL. This ARC is compared to actual contributions made and any difference is reported as the net OPEB obligation (NOO). In addition, required supplementary information (RSI) is required. This information includes historical information about the UAAL and the progress in funding the Plan.

SECTION 2: Valuation Results for the City of San Jose Police and Fire Department Medical and Dental Insurance Plan

HIGHLIGHTS OF THE VALUATION

- The annual required contribution (ARC) is \$68 million, once the actual contributions for 2006/2007 are known, the disclosure information in Chart 2 and Chart 4 can be completed.
- GASB requires that government entities with total annual revenues of \$100 million or more, such as the City of San Jose Police and Fire Department, commence with the Plan reporting under Statement 43 for fiscal years beginning after December 15, 2005
- The assumption for the discount rate is 4.50%, and is based on an analysis of the amount of assets currently held to pay for retiree health benefits relative to the retiree health liability. GASB Statement 45 paragraph 13 (c) states “... the investment return assumption (discount rate) should be the estimated long-term investment yield on the investments that are expected to be used to finance the payment of benefits, with consideration given to the nature and mix of current and expected investments...”. In addition, “The discount rate for a partially funded plan should be a blended rate that reflects the proportionate amounts of plan and employer assets expected to be used.”
- At a discount rate of 8.0%, the Actuarial Accrued Liability would have been \$589 million with a corresponding ARC of \$41 million. If the benefits under this plan were fully funded and those assets invested similar to the pension fund assets, this is the rate that would likely be used.
- The funding method used to develop the actuarial required contribution (ARC) is Entry Age Normal, with the normal cost developed as a level percent of payroll. The contribution to amortize the unfunded actuarial accrued liability (UAAL) is developed as a level percent of payroll. The maximum amortization period of 30 years allowed by GASB is used in this report.
- Contributions will generally increase with payroll growth. Other factors such as gains or losses, or changes in trend assumptions will also alter the ARC.

SECTION 2: Valuation Results for the City of San Jose Police and Fire Department Medical and Dental Insurance Plan

SUMMARY OF VALUATION RESULTS

The key results for the current year are shown.

	June 30, 2006
Actuarial Accrued Liability by Participant Category	
Current retirees, beneficiaries and dependents	\$469,344,884
Current active members	<u>493,493,935</u>
Total	\$962,838,819
Actuarial Value of Assets	\$38,381,423
Market Value of Assets	\$40,519,000
Unfunded Actuarial Accrued Liability	\$924,457,396
Funded Ratio	4%
Annual Required Contribution	
Normal cost	\$41,956,307
Amortization of the unfunded actuarial accrued liability	33,006,106
Less Employee Contributions	(8,260,094)
Adjustment for timing (payable throughout the year)	<u>1,686,654</u>
Total annual required contribution, including adjustment for timing	\$68,388,973

SECTION 2: Valuation Results for the City of San Jose Police and Fire Department Medical and Dental Insurance Plan

October 24, 2006

ACTUARIAL CERTIFICATION

This is to certify that The Segal Company has conducted an actuarial valuation of certain benefit obligations of the City of San Jose Police and Fire Department Retirement Plan other postemployment benefit programs for the year ending June 30, 2006, in accordance with generally accepted actuarial principles and practices. The actuarial calculations presented in this report have been made on a basis consistent with our understanding of GASB for the determination of the liability for postemployment benefits other than pensions.

The actuarial valuation is based on the plan of benefits supplied by the Police and Fire Department and on participant, claims and expense data provided by the Police and Fire Department.

The actuarial computations made are for purposes of fulfilling plan accounting requirements. Determinations for purposes other than meeting financial accounting requirements may be significantly different from the results reported here. Accordingly, additional determinations may be needed for other purposes, such as judging benefit security at termination or adequacy of funding an ongoing plan.

To the best of our knowledge, this report is complete and accurate and in our opinion presents the information necessary to comply with GASB with respect to the benefit obligations addressed.

Dave Bergerson, ASA, MAAA
Manager, Vice President, and Actuary

Patrick Twomey, ASA, MAAA
Assistant Actuary

SECTION 3: Valuation Details for the City of San Jose Police and Fire Department Medical and Dental Insurance Plan

CHART 1

Summary of Statement of Assets

	Year Ended June 30, 2006
Cash equivalents	\$69,827,000
Accounts receivable:	
Contributions	\$ 2,962,000
Brokers and others	127,311,000
Accrued investment income	<u>6,838,000</u>
Total accounts receivable	137,111,000
Investments:	
Fixed Income	\$ 607,494,000
Equities	1,557,094,000
Real Estate and Mortgages	184,255,000
Other	<u>426,779,000</u>
Total investments at market value	<u>2,775,622,000</u>
Total assets	\$2,982,560,000
Less accounts payable:	
Payable to brokers	-\$238,519,000
Security lending collateral	-426,787,000
Other	<u>-6,215,000</u>
Total accounts payable	<u>-\$671,521,000</u>
Net assets at market value	<u>\$2,311,039,000</u>
Net assets at actuarial value	<u>\$2,189,120,288</u>
Net assets at valuation value (Medical and Dental Plan)	<u>\$38,381,423</u>

Note Results may be slightly off due to rounding

SECTION 3: Valuation Details for the City of San Jose Police and Fire Department Medical and Dental Insurance Plan

CHART 2

Summary Statement of Income and Expense (Actuarial Value Basis)

	Year Ended June 30, 2006
Contribution income:	
Employer contributions	\$ 50,002,000
Employee contributions	<u>22,174,000</u>
Contribution income	\$72,176,000
Investment income:	
Interest, dividends and other income	\$ 60,565,000
Recognition of capital appreciation	122,609,968
Less investment and administrative fees	<u>-11,568,000</u>
Net investment income	<u>171,606,968</u>
Total income available for benefits	\$243,782,968
Less benefit payments:	
Payment of benefits	-\$92,872,000
Refunds of contributions	<u>-144,000</u>
Net benefit payments	-\$93,016,000
Change in reserve for future benefits	\$150,766,968
Net Actuarial Value of Assets at beginning of year	\$2,038,353,320
Net Actuarial Value of Assets at end of year	\$2,189,120,288

SECTION 3: Valuation Details for the City of San Jose Police and Fire Department Medical and Dental Insurance Plan

CHART 3

Determination of Actuarial Value of Assets as of June 30, 2006

1	Market value of assets, June 30, 2006				\$2,311,039,000
		Original Amount	Percent not recognized	Amount not recognized	
2	Calculation of unrecognized return*				
	(a) Year ended June 30, 2006	\$ 64,952,360	80%	\$ 51,961,888	
	(b) Year ended June 30, 2005	51,992,440	60%	31,195,464	
	(c) Year ended June 30, 2004	121,307,600	40%	48,523,040	
	(d) Year ended June 30, 2003	(48,808,400)	20%	(9,761,680)	
	(e) Year ended June 30, 2002	<u>(167,152,360)</u>	<u>0%</u>	<u>0</u>	
	(f) Total unrecognized return				\$121,918,712
3	Actuarial Value (1) – (2f), June 30, 2006				\$2,189,120,288
4	Actuarial value as a % of market				94.7%
5	Market value of postemployment healthcare assets				\$40,519,000
6	Valuation value of postemployment healthcare assets				\$38,381,423

*Total return minus expected return on a market value basis

SECTION 3: Valuation Details for the City of San Jose Police and Fire Department Medical and Dental Insurance Plan

CHART 4

Determination of Annual Required Contribution

Cost Element	June 30, 2006	
	Amount	Percent of Compensation ⁽¹⁾
1. Normal cost	\$41,956,307	19.20%
2. Amortization of the unfunded actuarial accrued liability 30 years, level % pay	33,006,106	15.10%
3. Less Employee Contributions	(8,260,094)	(3.78%)
4. Adjustment for timing (payable throughout the year)	<u>1,686,654</u>	<u>0.78%</u>
4. Total Annual Required Contribution	<u>68,388,973</u>	<u>31.30%</u>

⁽¹⁾ Estimated compensation for the 2006/2007 plan year of \$218,521,000 (See Segal's Reconciliation of the June 30, 2005 Pension Valuation Results – letter dated October 4, 2006)

SECTION 3: Valuation Details for the City of San Jose Police and Fire Department Medical and Dental Insurance Plan

CHART 5

Required Supplementary Information – Schedule of Employer Contributions

Plan Year Beginning	Annual Required Contributions	Actual Contributions	Percentage Contributed
June 30, 2006	68,893,865 ⁽¹⁾	N/A	N/A

⁽¹⁾ Includes an interest adjustment to the end of the plan year.

SECTION 3: Valuation Details for the City of San Jose Police and Fire Department Medical and Dental Insurance Plan

This schedule of funding progress presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits

CHART 6

Required Supplementary Information – Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded/ (Overfunded) AAL (UAAL) (b) - (a)	Funded Ratio (a) / (b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b) - (a) / (c)]
June 30, 2006	\$ 38,381,423	\$962,838,819	\$924,457,396	4%	218,521,000 ⁽¹⁾	423%

⁽¹⁾ Estimated compensation for the 2006/2007 plan year (See Segal's Reconciliation of the June 30, 2005 Pension Valuation Results – letter dated October 4, 2006)

SECTION 3: Valuation Details for the City of San Jose Police and Fire Department Medical and Dental Insurance Plan

CHART 7

Required Supplementary Information – Net OPEB Obligation (NOO)

Actuarial Valuation Date	Annual Required Contribution (a)	Interest on Existing NOO (b)	ARC Adjustment (c)	Annual OPEB Cost (a) + (b) + (c) (d)	Actual Contribution Amount (e)	Net Increase in NOO (d) - (e) (f)	NOO as of End of Year (g)
June 30, 2005	68,893,865 ⁽¹⁾	0	0	68,893,865 ⁽¹⁾	N/A	N/A	N/A

(1) Includes an interest adjustment to the end of the plan year

SECTION 4: Supporting Information for The City of San Jose Police and Fire Department Medical and Dental Insurance Plan

CHART 8

Required Supplementary Information

Valuation date	July 1, 2006
Actuarial cost method	Entry age normal, level percent of pay
Amortization method	30 years, level percent of pay
Remaining amortization period	30 years as of June 30, 2006
Asset valuation method	<p>The actuarial value of assets is a five-year smoothed market value of assets. This method recognizes 20 percent of the year's investment earnings in excess of (or less than) expected investment earnings in the current year and each of the four prior years.</p> <p>The expected value of assets for the year is the market value of assets at the beginning of the prior year brought forward with interest at the assumed rate of return to the end of the current year plus contributions minus benefit disbursements, all adjusted with interest at the assumed rate of return to the end of the current year.</p>
Actuarial assumptions:	
Discount rate	4.50%
Inflation rate	3.0%
Across-the-board pay increase	1.0%
Projected payroll increases	4.0%
Health care cost trend rate:	
• Medical	12% in 2006-2007 plan year, decreasing by 1% for each year for seven years until it reaches an ultimate rate of 5%
• Dental	5%
Plan membership:	June 30, 2006
Current retirees, beneficiaries, and dependents	1,386
Current active members	1,967
Total	3,353

SECTION 4: Supporting Information for The City of San Jose Police and Fire Department Medical and Dental Insurance Plan

*This exhibit summarizes
the participant data
used for the current
valuation*

EXHIBIT I

Summary of Participant Data

	June 30, 2006
Retirees	
Non-disabled	421
Disabled	<u>769</u>
Total	1,190 ⁽¹⁾
Average age	63.9
Surviving Spouses	
Number	196
Average age	67.9
Active Participants	
Number	1,967
Average age	41.7
Average years of service	14.1

(1) Includes 1,157 receiving medical benefits and 1,190 receiving dental benefits.

SECTION 4: Supporting Information for The City of San Jose Police and Fire Department Medical and Dental Insurance Plan

EXHIBIT II

Actuarial Assumptions and Actuarial Cost Method

Data:	Detailed census data and financial data for postemployment benefits were provided by Police and Fire Department
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Actuarial Cost Method:	Entry age normal, level percent of pay.
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Per Capita Cost Development:

Medical and Dental Annual Subsidy

The average annual retiree subsidies effective July 1, 2006 were assumed as shown below:

Dental*

Retiree – all ages:	\$1,167
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Medical*

Retiree - less than age 65:	\$4,529
Retiree - age 65 and over:	4,367
Surviving spouse - less than age 65:	4,529
Surviving spouse - age 65 and over:	4,367
Family – less than age 65	11,211
Family – age 65 and over	10,159

Administrative Expenses

No administrative expenses were valued separately from the claim costs.

** Average annual subsidies determined by taking total premiums paid and dividing by the number of participating retirees in the subgroup*

SECTION 4: Supporting Information for The City of San Jose Police and Fire Department Medical and Dental Insurance Plan

EXHIBIT III

Actuarial Assumptions and Actuarial Cost Method (continued)

In addition to the amounts shown above, we have valued an implicit subsidy paid by the actives for the retirees. The amounts of this subsidy for various ages are shown below:

age	retiree		spouse	
	male	female	male	female
55	\$ 4,603	\$ 4,756	\$ 3,626	\$ 4,107
60	5,467	5,123	4,852	4,761
64	6,273	5,437	6,125	5,358
65+	n/a	n/a	n/a	n/a

Marital Status

Actives at the time of retirement: 85% of employees assumed to have a spouse electing coverage

Retirees: Actual data included with census

Spouse Age Difference

Males are assumed to be 3 years older than their female spouses

SECTION 4: Supporting Information for The City of San Jose Police and Fire Department Medical and Dental Insurance Plan

EXHIBIT II

Actuarial Assumptions and Actuarial Cost Method (continued)

<i>Participation</i>	90% of the current participants are assumed to continue medical coverage at retirement.
	100% of the current participants are assumed to continue dental coverage at retirement
	90% of retirees reaching age 65 are assumed to be eligible for Medicare
<i>Assumption Changes Since Prior Valuation</i>	Health care cost trend rates have been updated
	Discount rate has been updated.

SECTION 4: Supporting Information for The City of San Jose Police and Fire Department Medical and Dental Insurance Plan

EXHIBIT II

Actuarial Assumptions and Actuarial Cost Method (continued)

Measurement Date: July 1, 2006

Discount Rate: 4.50%

Mortality Rates:

*After Service Retirement
and Pre-retirement:*

Males: 1994 Male Group Annuity Mortality Table (set back 4 years).

Females: 1994 Female Group Annuity Mortality Table (set forward 1 year)

After Disability Retirement

RP-2000 combined healthy male with no collar adjustment, projected 10 years.

Termination Rates before Retirement:

Age	Rate (%)		
	Mortality		Disability
	Service-Connected	Not Service-Connected	
25	0100	0125	0640
30	0100	0125	0930
35	0200	0150	1340
40	0300	0175	1990
45	0300	0250	3140
50	0400	0350	5050
55	0600	0525	2 1375
60	1000	0875	9 0750

SECTION 4: Supporting Information for The City of San Jose Police and Fire Department Medical and Dental Insurance Plan

EXHIBIT II

Actuarial Assumptions and Actuarial Cost Method (continued)

Withdrawal Rates:

<u>Years of Service</u>	<u>Rate (%)</u>
< 1	5.0
1 - 4	1.5
5 - 9	0.5
10+	0.6

Retirement Rates:

The following retirement rates apply to actives eligible for unreduced benefits:

<u>Age</u>	<u>Rate (%)</u>
50 - 64	17
65 - 69	35
70+	100

No retirement is assumed for members eligible for reduced benefits.

Salary Scale:

Annual Rate of Compensation Increase

Inflation: 3.00% plus "Across the Board" salary increase of 1.00% per year, plus merit and longevity as follows:

<u>Years of Service</u>	<u>Rate (%)</u>
0 - 5	6.00
6 - 7	3.00
8+	0.75

SECTION 4: Supporting Information for The City of San Jose Police and Fire Department Medical and Dental Insurance Plan

EXHIBIT II

Actuarial Assumptions and Actuarial Cost Method (continued)

Health Care Cost Subsidy Trend Rates:

Health care trend measures the anticipated overall rate at which health plan costs are expected to increase in future years. Trend rates are used to increase the stated subsidies into the future. For example, the proposed medical subsidy for a male retiree age 65 in the year July 1, 2007 through June 30, 2008 would be determined with the following formula: $[\$4,529 \times 1.12] = 5,072$

Year Ending June 30	Rate (%)	
	Medical	Medicare Part B and Dental
2008	12	5
2009	11	5
2010	10	5
2011	9	5
2012	8	5
2013	7	5
2014	6	5
2015 and later	5	5

Plan Design:	Development of plan liabilities was based on the substantive plan of benefits in effect as described in Exhibit III.
Administrative Expenses:	No administrative expenses were valued separately from the claim costs.

SECTION 4: Supporting Information for The City of San Jose Police and Fire Department Medical and Dental Insurance Plan

EXHIBIT III

Summary of Plan

This exhibit summarizes the major benefit provisions as included in the valuation. To the best of our knowledge, the summary represents the substantive plan as of the measurement date. It is not intended to be, nor should it be interpreted as, a complete statement of all benefit provisions.

Eligibility:	Retired for disability or service from active service with 15 years of service, or receiving a benefit of at least 37.5% of FAS. Also, if a member separates from service after July 5, 1992, with 20 years of service leaving contributions in the retirement plan until he applies for retirement benefits.
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Benefit Types:

Medical Plan Choices

Kaiser, BlueShield and PacifiCare

Dental Plan

Delta Dental and Enhanced Delta Dental

Medical Premiums

For retirees not eligible for Medicare, the Plan pays the lowest non-Medicare HMO premium rate. For retirees eligible for Medicare, the Plan pays the retiree's HMO premium plus the Medicare Part B premium, subject to the same maximums that apply to non-Medicare retirees. For 2006, the maximum subsidy is \$377.40 for a single member and \$939.72 for a family.

Dental Premiums

The Plan pays the entire premium.

Benefit

The same medical and dental coverage that the City provides an active member.

SECTION 4: Supporting Information for The City of San Jose Police and Fire Department Medical and Dental Insurance Plan

Active Plan Funding:

<i>Employee's Contribution</i>	Contribute 50% of the health cost and 25% of the dental cost as determined at each biennial actuarial valuation based on the cash flow requirement for the next ten years.
<i>City's Contribution</i>	Contribute 50% of the health cost and 75% of the dental cost as determined at each biennial actuarial valuation based on the cash flow requirement for the next ten years
<i>Changes Since Prior Valuation</i>	None

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